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SUBJECT: NIGERIA'S CENTRAL BANK PROPOSES NEW CLEARING SYSTEM

1. (U) Summary: On March 8 the Central Bank of Nigeria (CBN) announced a new clearing system aimed at strengthening the banking industry by preventing banks from overdrawing their CBN accounts. The new system reduces the number of clearing banks from 21 to 7, is self-regulatory, and will likely preclude weak banks from participating in clearing. The CBN expects to inaugurate the system on April 1, but the late passage of the FY2004 Budget may lead to a postponement. End summary.

Background

2. (U) The industry's clearing system has been characterized by banks' habit of overdrawing their clearing balances at the CBN. In the past, the CBN simply suspended defaulting banks from the clearinghouse, but public outcry over the 2003 suspension of two banks, Societe Generale Bank of Nigeria and African International Bank, prompted CBN officials and Bankers Committee members (bank CEOs, the Central Bank governor, and key CBN officials) to rethink the system, particularly in light of the fact that the two banks had overdrawn their accounts by several billion naira. Customers were taken by surprise and prevented from withdrawing their money, and the public blamed the CBN for failing to inform customers of the banks' financial health. In response, CBN officials decided to construct a self-regulatory system in which banks use perceptions of financial health to decide whether to provide clearing services for their counterparts.

Selection Criteria

3. (U) To qualify for the proposed clearing system, participating banks must have facilities capable of clearing checks in Nigeria's 22 clearing zones; maintain a minimum of 2.5 percent of deposits backing the total volume of checks cleared; and account for 2.5 percent of the total value of checks cleared. In addition, they must jointly provide clearing collateral of 105 billion naira (usd 772 million).

The Settlement Banks

4. (U) The CBN first selected Nigeria's three old-generation banks, First Bank, United Bank for Africa, and Union Bank of Nigeria, for the clearing system and then increased the number of clearing banks to five, adding two new-generation banks, Guaranty Trust Bank and Zenith International Bank. After a December 23 Bankers Committee meeting, the CBN added two more banks, Standard Trust Bank and Afribank, and increased the banks' clearing collateral from its original level of 75 billion naira (usd 551 million) to 105 billion naira (usd 772 million).

5. (U) Bankers Committee members agreed at the same time to periodically review the settlement banks' collateral to reflect transaction volumes, such that banks with the highest volumes will be required to set aside more funds as clearing collateral. The CBN has advised weak banks unable to find settlement banks to merge with their healthier counterparts to ensure participation in the clearinghouse. Banks that cannot merge or obtain clearing privileges will close.

Why postpone the commencement date?

6. (U) The CBN initially planned to launch the new system on January 1, but at the December 23 Bankers Committee meeting, officials postponed the system's inauguration to April 1 to allow time for banks to prepare for the change. The Bankers Committee hinged the postponement on the passage of the Year 2004 Budget, which it expects to be passed before the end of the first quarter.

Is it a laudable idea?

7. (U) Banking representatives welcome the proposed system,

saying that it was long overdue. According to Senator Faruk Bello, a former executive at Guaranty Trust Bank and now Vice Chairman of the Senate Committee on Banking and Currency, the proposed system will strengthen the banking industry and allow the CBN to spend more time focusing on its primary responsibility of shaping monetary and fiscal policy. Bello believes the CBN should focus on its area of competence while the banks handle clearing themselves.

18. (U) Comment: There is a 50/50 chance that the FY2004 Budget will not be passed before the end of the first quarter, so delays in the implementation of the new clearing system are likely. Even so, the proposed settlement system is a welcome change that may strengthen Nigeria's banking industry by forcing weak banks to merge or die a natural death. If the system improves the financial sector's health and efficiency, both depositors and business will benefit.
End Comment.
ROBERTS